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Contested Multilateralism as Credible Signalling: Why the AIIB Cooperates with the World Bank

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Over the past decade, rising powers have been acting to induce institutional change in major international institutions, including the World Trade Organization (WTO), the International Monetary Fund (IMF) and the World Bank (WB) (Hopewell 2015; Vestergaard and Wade 2015). Since established powers defended the institutional status quo rather successfully, China and its partners decided more recently to establish new international institutions, such as the Asian Infrastructure Investment Bank (AIIB), the New Development Bank and the Chiang Mai Initiative Multilateralization Agreement. Thus, rising powers have responded to their dissatisfaction with the degree of change they have been able to effect within the existing institutional order by setting up a set of new international institutions which overlap in their competences with legacy institutions. In conceptual terms, rising powers have exercised contested multilateralism (CM) (Morse and Keohane 2014). The essence of CM is that a group of states strategically uses one international institution – existing or newly created – as an instrument to contest the governance activities of another international institution.

Contested Multilateralism as Credible Signaling

In a recently published paper, we analyze how pursuing CM impacts on the ability of states to reap joint gains through institutionalized cooperation. We conceptualize CM as embedded in institutional adjustment bargaining between defenders and challengers of a given institutional status quo (Urpelainen and Van de Graaf 2014). More precisely, we understand the exercise of CM by the challengers of the institutional status quo to be a reaction to deadlock in institutional adjustment bargaining. Our premise is that deadlock results from challengers' inability to credibly communicate the degree to which they are resolved to challenge defenders over the institutional status quo.

Since CM aims at "crafting rules in one elemental regime that are incompatible with those in another" (Raustiala and Victor 2004: 301–302), it erodes the causal mechanisms through which – according to the logic of "cooperation under anarchy" – international institutions facilitate cooperation. CM breaks the convergence of expectations that define cooperation while it reduces the capacity of international institutions to serve as focal points among states (Drezner 2013). Thus, by re-introducing uncertainty about the behavior of actors, CM lessens the individual and collective gains states can capture through institutionalized cooperation.

However, we argue that precisely because it generates such costs, the exercise of CM can be an informative and credible signal that helps revitalize deadlocked processes of institutional adjustment bargaining. Because of its immediate political costs and risks, CM represents a clear signal of the challengers' dissatisfaction with the status quo and of their resolve to challenge it. By sending these signals, CM changes the institutional and strategic environment for institutional adjustment bargaining. In doing so, it can help prompt defenders and challengers to find new cooperative arrangements. Thus, our argument is that the very act of CM, precisely due to the costs it creates, may bring new dynamics into institutional renegotiations.

Moreover, we outline a path through which the revitalized negotiations can bring about the re-creation of the cooperation gains that were lost in the exercise of CM. We propose that functional needs are likely to push the two competing institutions – the original focal institution and the one brought into the game through CM – to seek

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coordination and cooperative arrangements in their everyday work. We argue that these pressures may lead to a new inter-institutional arrangement that emerges gradually, in an iterative process, accommodating the conflicts between the two institutions. If such an arrangement is indeed arrived at, CM will re-create the gains states realize through institutionalized cooperation.

Why China Created the AIIB and How It Relates to the World Bank

China's decision to create the AIIB and the evolving relationship of this newly established multilateral development bank with the WB exemplifies our theoretical logic. China's exercise of CM resulted primarily from its efforts to put pressure on the defenders of the institutional status quo in the WB. It was a reaction to a reform of voting shares in the WB that proved insufficient to accommodate the rise of China and other Non-Western states, continuing to severely under-represent them, in their view (Yang 2016: 766). In other words, China resorted to CM in response to its dissatisfaction with the institutional status quo in the WB and a reform of its governance structure which it perceived to be too meager (Knoerich and Urdinez 2019: 341, 353).

Especially given the US campaign against joining the AIIB, it was by no means certain that the AIIB would be able to attract many members (Freeman 2019). It was therefore not only costly but also risky for China to exercise CM by establishing the AIIB. In spite of that, the Bank proved able to attract considerable support in other world regions, most notably in Europe. Today, the AIIB has 102 approved members (which include many members of the WB and some close allies of the US), making it the world's second-largest MDB. At the same time, China enjoys a dominant position in the Bank. It possesses 26.64% of the vote shares, which contrasts with the 4.45% of the vote shares it holds in the WB. Thus, the creation of the AIIB increased the leverage of China (and other Non-Western members) within the WB.

In line with our theory, a number of negative effects on international cooperation in development finance was expected by major actors. The worry of many was that by giving Non-Western borrowers more institutional choices, the AIIB weakened the bargaining position of Western donors and the WB's enforcement mechanism. The availability of an alternative source of developing financing means that borrowing countries have weaker incentives to comply with the terms and conditions set out by the WB (Reisen 2015: 88).

To highlight the perceived dangers represented by the AIIB's creation to the existing order, China's exercise of CM has been described as being part of "China's shadow global diplomacy that aims at undermining the U.S.-led governance structures established after World War II" (Reisen 2015: 82). Thus, some commentators speculated that the establishment of the AIIB might lead to a "world of fragmented governance" (Subacchi 2015) and feared that the establishment of the AIIB signifies the creation of an institutional structure that competes against the World Bank as the central institution of development finance (Subacchi 2015; The Economist 2014). More precisely, it was argued that the AIIB may serve to institutionalize a "Beijing Consensus," based on the norm of non-interference with the internal affairs of countries, which competes against the "Washington Consensus," based on the norm of conditional lending (Chow 2016: 1263). In other words, as our theory leads us to expect, the expectation was that diverging conditionalities across the two banks induce a race to the bottom in the standards of international development finance and, by implication, lessen behavioral adaptation by the borrowers to the preferences of the lenders and vice versa (Knoerich and Urdinez 2019: 357).

However, equally in line with our theory, the effects of the creation of the AIIB on international cooperation are anything but unequivocal. The very creation of the AIIB almost immediately triggered a process of inter-institutional accommodation between the two development banks. Thus, actually, only relatively few cooperation gains got lost. To start with, China was only able to attract a global membership because it started to work towards inter-institutional accommodation with the WB early in the process of exercising CM (Rodrigues Vieira 2018; Wilson 2019). The members of the WB, in particular those with strong ties to the US, demanded a commitment to established norms and practices in multilateral development finance (Freeman 2019: 668, 670). In practice, they demanded that the AIIB is set up in a way that ensures at least basic complementarity with the WB and thus prevents large losses of cooperation gains due to a "race to the bottom" in the international standards of development finance.

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The ensuing process of inter-institutional accommodation manifested itself in two main ways. First, with the exception of the non-resident board of directors, the governance structure of the AIIB closely resembles the governance structure of the WB (Wilson 2019: 164). This is unsurprising because the AIIB used the WB mandate as a template for its own regulatory framework (Lichtenstein 2018). Second, interinstitutional accommodation between the AIIB and the WB is institutionalized in Memoranda of Understanding. The AIIB has developed a formal partnership with the WB which includes agreements on co-financing, knowledge-sharing, technical cooperation, risk management, policy strategy and staff exchanges, among others (AIIB 2019; World Bank 2017; see also Freeman 2019: 668). As a result, the AIIB and the WB became able to co-finance projects efficiently. Since the AIIB started to operate in 2016, a “significant portion of the AIIB’s projects” have been co-financed with the WB (Freeman 2019: 672).

In sum, not only does the AIIB’s governance structure resemble that of the WB, but also are its operations compatible, and executed jointly, with the WB. The exercise of CM through the creation of the AIIB by a group of states led by China therefore started as a direct challenge to the WB, but resulted in a process of inter-institutional accommodation between the two institutions

This empirical case corroborates two key theoretical claims: First, CM not only represents a reaction by the challengers of a given institutional status quo to deadlocked institutional adjustment bargaining, but also sends a credible signal of their resolve to contest it. Inherent in this signal is the potential to overcome deadlock by changing the dynamics of institutional adjustment bargaining. Second, “strategic inconsistency,” that is, the rivaling rules created by CM, may give rise to a process of inter-institutional accommodation which results in inter-institutional complementarity. By that, CM may re-create lost cooperation gains.

Against this backdrop, we suggest that if rising powers choose to engage in CM, they may very well gain from it, if inter-institutional complementarity is reached. At the same time, established powers are likely to minimize their losses if they do not resist adjustments of the incumbent focal institutions. And if institutional adjustment bargaining indeed fails and CM takes place, it is important that the established powers engage pragmatically in the processes seeking inter-institutional complementarity to regain most of the lost gains. The worst-case scenario is a permanent lock-in with conflicting sets of provisions and sizable losses of cooperation gains for both parties.

Towards a Logic of “Cooperation in a Thickly Institutionalized International System”

Our paper builds on existing research which elucidates how states take advantage of regime complexes to pursue their own interests (Alter and Meunier 2009; Helfer 2009; Jupille et al. 2013; Morse and Keohane 2014). While this research develops the micro-foundations for the theoretical analysis of international cooperation in the contemporary international system, it leaves unexplored the very fundamental question of how cross-institutional action impacts patterns of international cooperation and the ability of states to reap joint gains.

By tackling precisely this question, we contribute to developing a logic of “cooperation in a thickly institutionalized international system” which updates the well-established logic of “cooperation under anarchy” (Axelrod and Keohane 1985; Oye 1986). The latter revolves around two core assumptions: first, that international institutions are discrete entities which operate in isolation from one another and, second, that states pursue their interests and seek to maximize their payoffs through strategic action within individual institutions (Keohane 1984).

As the burgeoning literature on regime complexity demonstrates, neither of these assumptions is empirically fully accurate anymore. Contemporary international institutions are not discrete entities operating in isolation, but subject to inter-institutional influences and embedded in regime complexes (Alter and Raustiala 2018; Faude and Gehring 2017). As a result, states gain opportunities to pursue interests and maximize payoffs not only within, but also across overlapping international institutions (Jupille et al. 2013). Those possibilities for cross-institutional action affect the ability of international institutions to facilitate cooperation among states in a way that cannot be accommodated in the logic of “cooperation under anarchy.” To develop further the logic of “cooperation in a thickly institutionalized international system” is therefore an important task for all those interested in contemporary global governance.

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